Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	

COMMENTS OF VERIZON

Michael E. Glover

Of Counsel

Edward Shakin
Ann Rakestraw
1515 North Courthouse Road
Suite 500
Arlington, VA 22201
(703) 351-3174
ann.h.rakestraw@verizon.com

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Introduction and Summary

The rural high-cost program is by far the most expensive component of a rapidly increasing universal service fund. The proposals set forth by the State Members and Staff of the Federal-State Joint Board for Universal Service ("Joint Board") correctly highlight many of the major issues that must be addressed. Specifically, the fund must be reformed to ensure that universal service is "preserved" for areas where truly needed, while also taking steps to avoid funding areas and companies where support is unnecessary. Such fundamental change will thereby help control growth and protect the long-term viability of the fund and affordability of non-supported services.[2] One of the most pressing issues is the need to eliminate inefficient subsidies to multiple networks in the same area. As then-Commissioner Martin recognized long ago, it makes little sense to subsidize "multiple competitors to serve areas in which the costs are

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1 The Verizon telephone companies ("Verizon") are the local exchange carriers affiliated with Verizon Communications Inc., and are listed in Attachment A.

2 As courts have recognized, "excessive subsidization" may itself threaten the universal service principle of affordable service. *See, e.g., Qwest Communications v. FCC,* 398 F.3d 1222, 1234 (10th Cir. 2005) ("*Qwest II*").

prohibitively expensive for even one carrier."[3] Others in the Commission and on the Joint Board agree that something must be done to address the problem sooner, rather than later.[4] In addition, any proposal to give the states a larger role through the creation of a state block grant system must establish sufficient federal guidelines, and must allocate funds in a manner that does not create incentives for inefficient investment.

It will take time to work through many of the complex issues raised by competing proposals for long-term reform. However, action to control the fund size should not wait. As proposed by Joint Board Member Billy Jack Gregg, the Joint Board should recommend immediate steps the Commission can take to limit unwarranted growth in the fund while more fundamental reform is under consideration. Specifically, the Joint Board should recommend that the Commission immediately transition carriers with more than 100,000 lines in a state to the

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[3] *Multi-Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Second Report and Order and Further Notice of Proposed Rulemaking, Separate Statement of Commissioner Kevin J. Martin, 16 FCC Rcd 19613, 19770 (2001) ("*MAG Order*").

[4] *See, e.g., Federal-State Joint Board on Universal Service*, Report and Order, 20 FCC Rcd 6371, Separate Statement of Commissioner Michael J. Copps (2005) ("[M]uch more work needs to be done to secure the long-term sustainability of universal service. As ETC designations grow, new challenges will arise. In particular, the Commission will need to face the consequences of multiple designations in high-cost areas on the overall size of the fund."); *Federal-State Joint Board on Universal Service*, Recommended Decision, 19 FCC Rcd 4257, Separate Statement of Commissioner Kathleen Q. Abernathy (2004) ("*ETC Recommended Decision*") ("[I]t seems clear that the universal service fund can no longer subsidize an unlimited number of connections provided by an unlimited number of carriers"); *id*., Joint Separate Statement of Commissioners Jonathan S. Adelstein, G. Nanette Thompson, Regulatory Commission of Alaska, and Bob Rowe, Montana Public Service Commission, Approving in Part, Dissenting in Part ("[W]hen designating an ETC in an area served by a rural telephone company we must take greater care in examining the public interest to determine the wisdom of multiple ETCs in rural, high-cost areas"); *id*., Separate Statement of Billy Jack Gregg, Director of the Consumer Advocate Division, Public Service Commission of West Virginia ("I believe there are certain areas of this country where it is so expensive to provide service that it makes no sense to have more than one carrier subsidized by the federal universal service fund.").

same basis of high-cost support as non-rural carriers, and freeze per-line support to both rural ILECs and other eligible telecommunications carriers ("ETCs").[5]

I. THE CURRENT HIGH-COST PROGRAM IS GROWING AT LEVELS THAT THREATEN THE SUSTAINABILITY OF UNIVERSAL SERVICE, AND SUBSIDIZE INEFFICIENT INVESTMENT IN DUPLICATIVE NETWORKS.

The key problems that need to be addressed by the Joint Board are continued growth of the universal service fund, and the need to eliminate inefficient subsidies to multiple networks in the same high-cost areas.

A. The Continued Growth of The High-Cost Fund Must be Addressed.

In this proceeding, and other related proceedings for some time, commenters and Commissioners alike have recognized the need to limit the growth of the high-cost fund.[6] In the interim, the fund has continued to grow: total high-cost disbursements were $1.718 billion in 1999, yet by the fourth quarter of 2005, the high-cost fund requirements were almost a billion dollars *per quarter*.[7] Within the high-cost program, the "capped" rural fund grew from $874

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5 Throughout these comments, unless otherwise noted, the term "ETCs" will refer to carriers other than the incumbent LECs.

6 *See, e.g., ETC Recommended Decision*, Separate Statement of Commissioner Kathleen Q. Abernathy ("[I]t seems clear that the universal service fund can no longer subsidize an unlimited number of connections provided by an unlimited number of carriers."); Comments of CTIA, CC Docket No. 96-45, at 6 (Oct. 15, 2004) (*"CTIA ETC Comments*") (arguing that the rural fund is "a bloated fund that does not effectively target the appropriate levels of support"); Comments of BellSouth, CC Docket No. 96-45, at 3 (May 5, 2003); *Petition of Mid-Rivers Telephone Cooperative, Inc. for Order Declaring it to be an Incumbent Local Exchange Carrier in Terry, Montana Pursuant to Section 251(H)(2),* Notice of Proposed Rulemaking, 19 FCC Rcd 23070, 23077, ¶ 11 (2004) (finding that the "Commission has recognized the vital importance of avoiding excessive growth in the universal service fund size.").

7 Federal Communications Commission, Wireline Comp. Bur., Industry Analysis & Technology Div., Trends in Telephone Service, at Table 19.3 (Apr. 2005) ("*Trends in Telephone Service*"); *see* Federal Universal Support Mechanisms Fund Size Projections for the Fourth Quarter 2005, USAC, Appendix HC02 (August 2005) ("*USAC 4th Quarter 2005 Projections*") (projecting annualized high-cost support funding to be $3.995 billion).

million in 2000 to $1.137 billion in 2004, roughly a one-third increase in the fund in only four years. *See Trends in Telephone Service,* Table 19.3.[8]

The overall size of the universal service fund is growing to levels that could threaten two of the primary goals of the universal service program: sustainability of the fund, and affordability of telecommunications services for all Americans. *See* 47 U.S.C. § 254. Even if there were no additional growth in the high-cost fund, by the end of 2005 the total high-cost fund would be more than $3.995 billion per year – more than double the size of high-cost mechanism from just six years ago. *See USAC 4th Quarter 2005 Projections*, at Appendix HC02. The sheer size of the current fund and the precipitous spike in support in the past few years alone should trigger a fundamental review of the high-cost program and an examination of whether the currently configured program efficiently and effectively meets the requirements of Section 254.

Without effective controls, the demand for high-cost funding will continue to rise. The growth source that has the greatest potential to spiral out of control is the funding of multiple ETCs in high-cost areas. In 2000, $1 million in high-cost subsidies were spent on such support; by 2002 that figure grew to $46 million, and last year the figure had reached $333 million.

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8 The current "cap" only limits support to the ILEC, but does not cap growth to other ETCs, and does not sufficiently control funding levels provided to rural LECs. The Rural Task Force explained: "[A]n incumbent carrier's loss of subscriber lines to a competitive eligible telecommunications carrier is unlikely to be offset by a corresponding reduction in its total embedded cost of service. If the incumbent's lines decreased while its fixed costs remained roughly the same, its per-line costs would increase. Consequently, the incumbent would be entitled to higher support per line. Because the higher per-line support amount would be available to both the incumbent and the competitor for each line served under our portability rules, the size of the fund could grow significantly as competition increases, particularly if there is a net increase in the total number of lines served in the study area. The indexed cap on high-cost loop support would not check this growth fully, because support received by competitive carriers currently is not included within the cap." *Federal-State Joint Board on Universal Service,* Fourteenth Report and Order, 16 FCC Rcd 11244, 11295-96, ¶ 125 (2001) ("*Rural Task Force Order*").

Trends in Telephone Service, Table 19.5. In less than five years, the share of high-cost funds spent to subsidize duplicative networks in high-cost areas skyrocketed from 0.1 percent to 9.5 percent. *Id.* With respect to lines served, in the last twelve months alone, the total number of such ETC lines in study areas served by rural carriers jumped 32 percent.[9] Importantly, as described in greater detail below, subsidies provided to ETCs are generally in addition to, not in lieu of, support provided to the incumbent LECs.

Growth in the high-cost fund also results from cost increases of rural ILECs. Ignoring increases attributable to new ETCs, funding to rural carriers under the rural high-cost fund grew approximately 25 percent from 1999 to 2004. *See* Federal-State Joint Board Monitoring Report, Table 3.2 (October 2004) ("*2004 Monitoring Report*"). Under the current funding mechanism, there is little incentive for high-cost rural carriers to control costs, because as their costs increase, so do their universal service subsidies. *See* footnote 8, *supra.* While disproportionately high-cost areas may warrant support to preserve universal service, the continued need for federal funding to communities in which adequate revenues could be derived from raising end-user rates to reasonable, yet affordable, levels is less clear.

It remains an open question whether this rapid expansion of subsidized lines and increased support to rural LECs has furthered the basic tenets of universal service, which is intended to "benefit the customer, not the carrier." *Alenco Communications v. FCC,* 201 F.3d 608, 621, n.17 (5th Cir. 2000) ("*Alenco*"). Because ratepayers throughout the country must

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9 *Compare* Federal Universal Support Mechanisms Fund Size Projections for the Fourth Quarter 2004, USAC, Appendix HC18 (August 2004) to *USAC 4th Quarter 2005 Projections*, Appendix HC18. (reporting that the total number of non-incumbent ETCs lines serving study areas of rural carriers grew from 2.192 million to 2.895 million from fourth quarter 2004 to fourth quarter 2005).

ultimately pay for these significant outlays, funding unnecessary or inefficient investments increases the cost of telecommunications services to all consumers, running the risk of violating the goal that all rates remain "affordable." 47 U.S.C. §§ 1, 254(b)(1); *Alenco*, 201 F.3d at 620 ("[E]xcess subsidization in some cases may detract from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market."); *see also Qwest II,* 398 F.3d at 1234. Continued increases in the size of the fund may also exceed the capacity of any carrier-based contributions system to fund it, undermining the long-term sustainability of the universal service program as a whole.

B. The Funding of Duplicative Networks Exacerbates Growth Concerns and is Inconsistent with Section 254.

The USERP accurately concludes that the Commission should provide no "more support than is necessary to achieve affordability and comparability." *Federal State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules Relating to High-Cost Universal Service Support,* Public Notice, FCC 05J-1, at 22 (Aug. 17, 2005) ("*Notice*"). As several past and present members of the Joint Board have noted, "it seems clear that the universal service fund can no longer subsidize an unlimited number of connections provided by an unlimited number of carriers." *ETC Recommended Decision*, Separate Statement of Commissioner Kathleen Q. Abernathy. Chairman Martin has long expressed "concerns with policies that use universal service support as a means of creating 'competition' in high-cost areas." *ETC Recommended Decision*, Separate Statement of Commissioner Kevin J. Martin, Dissenting in Part, Concurring in Part. Other commissioners share his concerns.[10] The universal

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[10] *See ETC Designation Order,* Separate Statement of Commissioner Michael J. Copps ("[T]he Commission will need to face the consequences of multiple designations in high-cost areas on the overall size of the fund."); *id.*, Separate Statement of Commissioner Jonathan S. Adelstein (the FCC can do more "to explore frameworks to identify those very high-cost areas

service fund is not meant to foster competition, but rather to support affordable rates in rural, insular, and high-cost areas. Continuing to subsidize duplicative investment in high-cost areas risks creating a new class of carriers dependent on government subsidies, and threatens the sustainability of the overall universal service program by adding ever-increasing costs to ratepayers across the country. Nonetheless, a growing portion of universal service dollars is being spent not on basic infrastructure needs, but to fund purported "competition."

Under the current mechanism, funding multiple carriers in the same study area increases the size of the rural high-cost fund in one of two ways: if the support is for additional customer lines (*e.g.*, the customer is receiving support from both the ILEC and the ETC), the ETC funding is over and above existing rural high-cost funding amounts. In other words, more universal service dollars for ETCs does not lead to a corresponding decrease in the funding provided to incumbents. If the support is provided to lines that are new or captured from the rural ILEC, it is possible that as the ILEC loses lines, the per-line rate – for both the ILEC and ETC – will increase. *See Rural Task Force Order,* at 11325-26, ¶¶ 207-211. In addition, under current rules, there is no control on this growth. *See* footnote 8, supra. Thus, as each new ETC is designated in a rural area, the fund size grows.

II. THE JOINT BOARD SHOULD RECOMMEND WAYS TO CONTROL GROWTH, AND ELIMINATE INEFFICIENT SUBSIDIES TO DUPLICATIVE NETWORKS.

The proposals offered by Joint Board Members/Staff have sparked a much-needed dialogue on longer-term, holistic universal service reform. Any long-term solution to high-cost reform should consider not just reform of the rural fund, but also any implications to the non-

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where it may be prohibitive to fund more than one ETC" and "address the impact of ETC designations on the universal service fund").

rural mechanism, particularly in light of the 10th Circuit's *Qwest II* decision.[11] When considering what reforms to recommend, the Joint Board should strive to curtail funding of redundant networks, control the size of the total universal service fund, and provide more efficient and effective funding that is targeted to where it is needed to preserve universal service. The Joint Board should further ensure that any discretionary authority provided to states is consistent with Section 254 and ensures state responsibility and accountability. Any new mechanisms should also be as straightforward and simple to implement and administer and not rely on the creation of complicated cost models.

A. The Joint Board Should Recommend Commission Action to Limit Universal Service Support to Duplicative Networks Serving the Same Areas.

Although in the *Portability Proceeding* the Commission declined to adopt a Joint Board proposal to "limit the scope of high-cost support to a single connection per household," in that case the proposal had been effectively foreclosed by legislative action. *ETC Designation Order*, 20 FCC Rcd at 6376, 6379, ¶¶ 11, 16 (2005). However, other actions, consistent with Congressional action, can be taken to control funding increases to multiple ETCs in a study area. The restrictions on granting additional ETCs and other ETC regulation and reporting requirements adopted in the *Portability Proceeding* may remain ineffective in checking the size of the USF growth.[12] Accordingly, the Joint Board should recommend that the Commission

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[11] Although *Qwest II* involved an appeal of the non-rural mechanism, the Court there raised questions about the difference between urban and rural rates, and remanded the case to the Commission for further consideration of statutory definitions "sufficient" and "reasonably comparable." *Qwest II,* 398 F.3d at 1233-38.

[12] *See ETC Designation Order,* Separate Statement of Commissioner Jonathan Adelstein ("I would have considered additional measures to strengthen FCC designation of ETCs and to address the impact of ETC designations on the universal service fund.").

revisit the issue of funding to multiple carriers by limiting subsidy permits to one carrier per study area.

The appropriations language that led the Commission to defer action on a primary line proposal was silent with respect to limiting the total number of carriers serving an area, prohibiting only action on a single or primary line restriction.[13] Indeed, in the Act itself, Congress clearly recognized that, particularly in rural areas, subsidizing more than one carrier may well not be in the public interest: Section 214(e) of the Communications Act permits, but does not require, a state commission to grant more than one carrier eligible telecommunications carrier status in the service territory of a rural telephone company. Even if there were unlimited universal service funds available (which there are not), using high-cost funds to subsidize multiple providers to customers does not make sense as a matter of policy. This is particularly true when such providers often have gained significant market share without the benefit, or need, of universal service support.[14]

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13 *See ETC Designation Order,* at 6378, ¶ 16 ("2005 Consolidated Appropriations Act prohibit[s] the Commission from utilizing appropriated funds to 'modify, amend, or change its rules or regulations for Universal Service support payments to implement the February 27, 2004 recommendations of the Federal-State Joint Board on Universal Service regarding single connection or primary line restrictions on universal service support payments.'").

14 Many petitioners seek ETC status in areas where they already provide service, even without universal service support. *See, e.g.,* Joint Petition For Designation as Eligible Telecommunications Carrier in the State of New York, CC Docket No. 96-45, at 14 (May 3, 2004) (noting an increased "facilities deployment by large national carriers of their own facilities along [rural highway] corridors" and that the existence of such corridors in Dobson's service area "has provided valuable revenue streams to finance costly deployment to serve rural customers outside the corridors").

B. Any Long-Term Solution Must Further Focus On Controlling The Size Of The Universal Service Fund.

While reducing the number of networks subsidized under the fund is a key first step to a long-term solution to high-cost reform, more must be done to control the size of the fund. Since its *First Report and Order,* the Commission has highlighted the need to "moderate growth in the high-cost loop fund," but the current indexed cap applicable to the rural fund has proven insufficient to adequately control fund growth. *See, e.g., Rural Task Force Order,* at 11265, ¶ 41. As demonstrated above, the "capped" rural fund increased by roughly one-third in total size from 1999 to 2004. *See Trends in Telephone Service,* Table 19.3. Much of this growth is due to the funding of multiple competitors in high-cost areas, which the Commission should address directly. *See* Section I.B, *supra*. However, it also should adopt a per-line freeze on all support under the rural high-cost fund, which could provide a more tenable long-term solution to overall fund size growth. *See* Section III.C, *infra*.

C. Any Block Grant Proposal Must Include Sufficient Federal Guidelines and Ensure Clear State Accountability, and Must Set Effective Formulas for Allocation of Funds Between the States to Control Fund Growth.

All of the State Members' plans include some variation of a block grant program, under which states would be provided greater discretion to determine necessary allocations of support to carriers. *See Notice* at 3, 12, 14, 24. The proposals focus on Section 254's provision for a dual federal-state administration of the universal service program.[15] To satisfy the federal

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[15] Section 254 provides for the establishment of "Federal universal service support mechanisms," but also contemplates a clear role for state commissions in achieving universal service goals: "A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service." 47 U.S.C. § 254(e-f). State commissions are also provided additional authority to rule on ETC applications related to universal service under Section 214 of the Act. 47 U.S.C. § 214(e). The FCC has provided states authority to certify that ETCs will use federal funds consistent with Section 254, and a block grant program subject to strict federal guidelines and oversight would be consistent with that delegation. *See* 47 C.F.R.

responsibilities under Section 254, any such block grant program must include strict and specific federal guidelines, and cannot abdicate federal authority over allocation decisions. In addition, any move to block grants should be accompanied by a cap in the overall fund size, so as to ensure that the flexibility given to the states in the block grant program does not trigger over-spending.

To pass legal muster, any block grant system would still require the Commission to maintain clear oversight and audit authority over the states. *See Qwest Corp. v. FCC,* 258 F.3d 1191, 1204 (10th Cir. 2001) (concluding that the "FCC may not simply assume that the states will act on their own to preserve and advance universal service"). The State Members' proposals recognize the need for such guidelines and federal oversight, but details about what the specific guidelines would be still need to be developed. *Notice* at 5, 12, 24. Any federal guidelines must set forth specific factors the states must consider in distributing funds. These should include not just data regarding carriers' reported costs, but also market conditions, revenues, and rates, so that states can determine whether universal service goals already are being met – or are capable of being met – without the necessity of expending universal service dollars.[16] Moreover, "distributions should be predictable and should be based on published data and explicit and predetermined calculations." *Notice* at 24.

§§ 54.313, 54.314. Because of the collaborative federal-state role under Section 254, so long as there exist adequate federal guidelines and oversight of a block grant program, the Commission would not face the same legal problems associated with improper delegation of authority that were at issue in *USTA II*. *United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004).

[16] For example, if multiple carriers already serve customers in a given high-cost area, there is no reason to spend universal service subsidies to create "competition."

Although a block grant system would give more flexibility to the states to determine intra-state needs, it should be tied to a specific cap on overall federal high-cost support, so that individual state requests for funding do not lead to an expansion of demand for support. Moreover, in developing specific formulas for allocation of funds between the states, any block grant system must not create incentives for inefficient subsidies. For example, the Joint Board should *not* recommend offering increased federal universal service subsidies based solely on an increase in the number of supported lines, as this would create incentives to maximize the number of ETCs in a state, so the state could get a larger share of the pie.[17] Rather, by giving states a set amount of money, and creating restraints that would not allow for unlimited growth of the fund, "States would have large incentives to maximize consumer welfare by using their allocations in the most efficient way."[18]

Any block grant proposal also should be limited to high-cost relief, and should not attempt to incorporate other universal service goals. Specifically, the Joint Board should *not* accept proposals for allocating low-income support on a block grant basis to the states. *See, e.g.*, *Notice* at 3. The Lifeline and Link-up programs are currently administered through an efficient reimbursement mechanism whereby carriers provide discounts directly to qualifying customers, and carriers seek reimbursement from the fund. There is no added benefit to inserting an additional regulatory body in this system. Although the FCC has been concerned about

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[17] *See ETC Recommended Decision,* Separate Statement of Lila A. Jaber, Florida Public Service Commission ("Some commenters believe that states have used multiple carrier ETC designation as a means to attract more universal service funds into the state.").

[18] *Notice* at 3-4. Although Joint Board Member Ray Baum's State Allocation Mechanism proposal states that "[e]very dollar given to one ETC would be a dollar that could not be given to another," *id.*, this is only true if the state does not receive additional federal funding with the addition of multiple supported lines per customer. *See* Section I.B., *supra.*

maximizing the number of eligible customers actually receiving aid, a "block grant" mechanism would not address this issue but, rather is only targeted to identifying overall what funding levels should be required. *Lifeline and Link-Up,* Report and Order and Further Notice of Proposed Rulemaking, 19 FCC Rcd 8302, 8305, ¶ 1 (2004). Expanding the "take rate" of the low-income proposals is best addressed through communications with consumers or other mechanisms already being considered for implementation. *Id.,* at 8325-29, 8333, ¶¶ 41-49, 58.

D. The Joint Board Should Consider Solutions that Do Not Require the Creation of Complicated Cost Models.

A number of the Joint Board proposals would require the creation of new resource-intensive forward-looking cost or embedded-cost models as well as additional cost/revenue benchmarks that would interject any number of unpredictable variables into the process. *Notice* at 3-5, 10. It took the Commission over two years to adopt the Hybrid Proxy Cost Model currently used to allocate non-rural high-cost loop funding,[19] and there has been continuing controversy as to whether that model achieves the purposes for which it was intended. *See* Petition for Reconsideration of the Maine Public Utility Commission and Vermont Public Service Board, CC Docket No. 96-45 (filed Feb. 22, 2002). The cost and time to implement a new model or benchmark could be expected to take at a minimum the same amount of time. And it is unclear if such a model could adequately provide predictable support levels even if that effort were made.[20] The Commission would better spend its time crafting a simpler, more

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[19] *Federal-State Joint Board on Universal Service,* Tenth Report and Order, 14 FCC Rcd 20156 (1999) (*Inputs Order*), *aff'd Qwest I.*

[20] The Commission itself refused to apply the non-rural mechanism to all rural carriers based on the variability the model could produce for rural carriers. *See, e.g., Rural Task Force Order.*

straightforward funding mechanism, rather than crafting a new model. *See* Sections II.A-B, *supra*.

III. THE JOINT BOARD SHOULD RECOMMEND THAT THE COMMISSION TAKE INTERIM STEPS TO PROTECT AGAINST UNWARRANTED FUND GROWTH AND ENSURE MORE EVENHANDED FUNDING.

The Joint Board should promptly recommend additional "short-term" steps the Commission can take to immediately control growth of the high-cost fund and ensure that the mandates of Section 254 are met, while more fundamental reforms are evaluated. A number of the State Members' plans offer such "short-term" or interim proposals, including Joint Board Member Gregg's recommendation that the Commission refocus its funding of larger rural carriers by consolidating all study areas commonly owned within a state and transitioning the largest subset of rural carriers (those with over 100,000 lines within a state) to the non-rural mechanism, absent unique circumstances. *See, e.g., Notice* at 8, 10-13. Within the rural mechanism, the Commission should also address the mushrooming of subsidies provided to both ETCs and rural ILECs by freezing all per-line high-cost support. *Id.*

A. All Study Areas Within a State Should Be Consolidated For Universal Service Purposes.

Under current rules for funding high-cost loops, there exists a mathematical anomaly whereby a carrier often can receive more funding if it operates in multiple study areas in the state than it would if all of its lines were consolidated into one study area. The effect of this anomaly is amplified by the current assignment of study areas in many states in which a single carrier often operates in multiple study areas – an unintended consequence of the FCC's study area freeze and the rapid consolidation of rural properties over the past decade. *See* Comments of Verizon, CC Docket No. 96-45, 5-8 (Oct. 15, 2004) ("*Verizon Comments*"). Consolidating a carrier's study areas within each state is consistent with the operation of many rural carriers,[21] and allows the funding formula to reflect the operational realities of larger (rural and non-rural) carriers, thereby reducing inequitable results among similarly situated carriers.

The study area freeze itself was established twenty years ago to prevent carriers from maximizing high-cost funding through manipulation of study area boundaries, yet, in practice, the freeze may present a new means by which carriers can affect high-cost funding levels: *i.e.,* the operation of multiple unconsolidated study areas within a state.[22] Prompt action to address this problem is warranted.

Joint Board Member Gregg proposes that "[a]ll study areas within a state owned by a single company would be combined into one study area for universal service purposes."[23] This plan is directly responsive to the specific concern highlighted by the Commission that "[b]y operating in multiple study areas in a given state, certain carriers may receive more high-cost

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21 Many existing study areas of rural carriers consist of collections of smaller, non-contiguous areas. Despite the scattered nature of these exchanges, they are part of a single geographic unit for purposes of determining average loop cost and universal service support. There is no evidence to suggest that the same statewide determinations would not be equally effective for those carriers currently operating in multiple study areas through acquisition within a state. The failure to require consolidation in those instances potentially rewards in a discriminatory manner those carriers that acquired rural properties subsequent to the study area freeze.

22 *See, e.g., Request for Clarification Filed by the NECA, Inc. and Petitions for Waiver Filed by Alaska Telephone Company, Ducor Telephone Company and Kingsgate Telephone, Inc.*, Memorandum Opinion and Order, 11 FCC Rcd 8156, 8157 ¶ 2 (1996) (finding that the study area freeze was established "primarily to ensure that ILECs do not place high-cost exchanges within their existing service territories in separate study areas to maximize payments from the Universal Service Fund ("USF") support program").

23 *Notice* at 8. A "single company" should include multiple study areas served by either the same carrier or by operating subsidiaries commonly owned at the holding company level. *See Verizon Comments* at 5. Because study area consolidation under Gregg's proposal is for universal service purposes only, it can be implemented immediately based on cost data for carriers' entire combined study areas within a state. There is no need for a transition period.

universal service support than they would if their study areas within the state were combined."[24] From an equity perspective, a carrier operating 120,000 lines in a state should not be regulated differently if those 120,000 lines are located in one, two, or sixteen different study areas.[25] By more directly linking universal service support to statewide operations, Gregg's proposal would foster additional efficient rural investments, properly calibrate federal funding, and limit high-cost loop support to areas where it is not necessary.

B. Carriers With More Than 100,000 Lines Should be Transitioned to the Non-Rural Mechanism.

Beyond consolidation of commonly owned study areas, Joint Board Member Gregg's proposal to shift all carriers serving 100,000 lines or more within a state to model-based support should also be adopted as an interim measure.[26] The Holistically Integrated Package proposal also supports this approach. *Notice* at 17. There is no statutory requirement to provide support

[24] *Federal State Joint Board On Universal Service,* Order, 19 FCC Rcd 11538, 11544, ¶ 12 (2004) ("*Referral Order*"). Under the Act, a carrier can qualify as a "rural telephone company" if it operates fewer than 100,000 access lines in a study area. 47 U.S.C. §153(37)(C). As a result, a carrier with 99,000 access lines in one study area and 99,000 access lines in an adjacent study area in the same state can qualify as a rural telephone company, even though it would not be if the carrier's total statewide operations were considered, *i.e.,* 198,000 access lines. If its study areas were consolidated, this carrier would no longer be classified as rural (absent fitting into another category within the definition of rural telephone company). This carrier would, therefore, receive support under the high-cost mechanism in the same manner as similarly sized providers.

[25] The transition to carrier statewide costs would also more closely track the operation of the non-rural fund. Non-rural carriers receive universal service support based on the results of the Hybrid Proxy Cost Model applied on statewide data rather than on individual study area data.

[26] As Gregg's proposal recognizes, due to the unique nature of Alaska and insular areas, there is a need to support these areas differently in light of their unique operational and demographic challenges. *Notice* at 9 (suggesting that large insular carriers "would continue to use the current modified embedded cost methodology" because of their unique characteristics); *see also Verizon Comments* at n. 20 ("Insular carriers … can have significantly different cost characteristics because of the unique and difficult challenges they can face in serving island territories. Therefore, a unique universal service mechanism needs to be adopted for insular carriers based on their unique characteristics.").

based on a carrier's "rural" or "non-rural" categorization.[27] Moreover, Gregg's proposal is consistent with the FCC's directive to "take into account the significant distinctions among rural carriers."[28] Gregg's proposed 100,000-line threshold is appropriate, as it captures the largest carriers receiving funding under the rural mechanism, without adversely affecting any small rural providers. The Joint Board found that more than 40 carriers serving more than 100,000 lines qualify as rural under the current definition.[29] In fact, the use of 100,000 lines is consistent with the Rural Task Force's and Joint Board's past categorization of rural carriers, and far more cautious than the threshold (50,000 lines) suggested by the Commission.[30] Moreover, a line-count threshold is far superior to other proposed criteria, such as line density or other geographic units such as census tracts, which are fraught with data collection, enforcement, and administrative problems. *See* Reply Comments of Verizon, CC Docket No. 96-45, at 10 (Dec. 14, 2004) (citing comments of others). All carriers transitioned to the non-rural mechanism

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[27] *See Verizon Comments at* 9; *see also Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, 19 FCC Rcd 16083, 16087, ¶ 9 (2004) ("*2004 Notice*") (finding that Section 254 does not require "the Commission use the Act's definition of rural telephone company for high-cost universal service purposes").

[28] *Referral Order*, at 11538, ¶ 1; *see also The Rural Difference,* Rural Task Force, White Paper 2, at 7 (Jan. 2000) ("*Rural Difference White Paper*") (addressing the need for "[a]n understanding of differences *between* Rural Carriers and non-Rural Carriers, and diversity *among* Rural Carriers").

[29] These carriers include Citizens Communications Company (2.29 million total lines), ALLTEL Corporation (2.91 million total lines), Sprint Corporation (7.85 million total lines), and CenturyTel, Inc. (2.38 million total lines). *See 2004 Notice,* at 16086-87, ¶ 8; *Verizon Comments* at 10-11; *see also Rural Difference White Paper,* at 9, 25-26 (corroborating the stark size differences between small and larger rural carrier study areas: larger carriers (more than 100,000 lines in a study area) account for a very small percentage of the total number of rural study areas (1.5 percent), yet those few study areas account for more than 27 percent of rural lines).

[30] *2004 Notice*, ¶ 14; *see also Referral Order,* at 11543 ¶ 11 (finding that "the Joint Board should consider whether it would be appropriate to use forward-looking economic cost estimates to determine high-cost support for rural telephone companies with more than 50,000 lines in a state").

should receive support based on statewide averages, consistent with the current operation of the non-rural mechanism.

C. Per-Line Funding Under the Rural Mechanism Should be Frozen.

Despite the "indexed cap [under the rural mechanism], which limits total support to the previous year's total, increased by the rate of annual loop growth for all carriers," the rural mechanism continues to increase. *Rural Task Force Order,* 16 FCC Rcd at 11251, ¶ 13.[31] The continued failure of current safeguards to control effectively such growth necessitates further reform.

Notwithstanding the need for more fundamental reform to address fund growth, the Joint Board should recommend an immediate freeze on all per-line support for study areas remaining under the rural high-cost mechanism. The effect of the unchecked addition of ETCs (both in total number and lines served) and the continued potential for rural ILECs to augment funding levels through inefficient network investment warrant immediate corrective action. *See* Section I.A, *supra*. Freezing per-line support would provide an incentive for carriers to make more prudent investment decisions, while still maintaining sufficient levels of universal service support. A per-line freeze would ensure that rural carriers continue to receive sufficient universal service support as required by the Act, in a manner similar to the current high-cost funding cap.[32]

Frozen per-line support should be based on the ILEC cost and line count data for the twelve-month period prior to the effective date of the new rules, and should be adjusted annually

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31 For an explanation of why the current cap is not effective, see footnote 8, *supra*.

32 *See also Alenco,* 201 F.3d at 620 (finding that "[t]he cap's track record, however, reflects a reasonable balance between the Commission's mandate to ensure sufficient support for universal service and the need to combat wasteful spending").

by an indexed factor. The indexed factor itself could be linked to the number of supported loops (as Gregg proposed) or to some other objective measurement, including community population changes. *See also Rural Task Force Order*, ¶ 120. Such a factor should ensure that funding levels cannot be manipulated through increasing the number of ETCs. In recognition of the need for more comprehensive reform to control overall fund growth, this proposal is broader than the per-line freeze suggested by Joint Board Member Gregg, which would freeze support only upon entry of ETCs in an ILEC study area. *Notice* at 8-9.

IV. CONCLUSION

For the foregoing reasons, the Joint Board should recommend specific long-term and interim solutions to control growth of the high-cost fund, and limit the funding of redundant networks in high-cost areas.

Respectfully submitted,

THE VERIZON TELEPHONE COMPANIES

By: *_/s/ Ann Rakestraw_*

Michael E. Glover
Of Counsel

Edward Shakin
Ann Rakestraw
VERIZON
1515 N. Court House Road
Suite 500
Arlington, VA 22201-2909
703.351.3174

COUNSEL FOR VERIZON

ATTACHMENT A

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Southwest Incorporated d/b/a Verizon Southwest
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Hawaii Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.